

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the City of Asheville (the “City”) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The City’s significant accounting policies are described below.

The City has implemented GASB 40, Deposit and Investment Risk Disclosures: which is an amendment to GASB Statement 3 and modifies disclosure requirements for deposit risks.

A. Reporting Entity

The City of Asheville is a municipal corporation that is governed by an elected mayor and a six-member council. As required by GAAP, these financial statements present the City and its component units as legally separate entities for which the City is financially accountable. Blended component units, although legally separate entities, are, in substance, part of the City's operations and, as such, are included in the reporting entity. The discretely presented component unit below is reported in a separate column in the City's financial statements in order to emphasize that it is legally separate from the City.

Included within the reporting entity:

Asheville Board of Alcoholic Control (the ABC Board). The Asheville Board of Alcoholic Control was organized under the provisions of House Bill No. 1124 of the North Carolina General Assembly and implemented by a citywide election held November 14, 1947. The local ABC Board may borrow money in accordance with North Carolina General Statute 18B-702(b) and the City's governing body who appoint all three ABC Board members shall in no way be held responsible for the debts of the ABC Board. The ABC Board is required by state statute to distribute its surpluses to the General Fund of the City, which represents a financial benefit to the City. Therefore, the ABC Board is reported as a discretely presented component unit. Complete financial statements for the ABC Board may be obtained from the Asheville Board of Alcoholic Control's administrative offices at 1 Cherry Street North, Asheville, NC 28801.

Asheville Public Financing Corporation (the APFC). The Asheville Public Financing Corporation is a non-profit corporation chartered in 1991 with the specific purpose of assisting the City of Asheville in various types of financing arrangements. The Corporation is governed by a board of directors whose three members serve for one year or until successors are elected. One of the three members is appointed by the city manager. The board of directors elects the remaining directors. The Corporation has no assets or liabilities. All rights, title and interest to all financing contracts with the City have been assigned to various bank trustees. All financing arrangements with the City have been disclosed in the accompanying notes to basic financial statements.

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Asheville Claims Corporation (the ACC). The Asheville Claims Corporation is a non-profit corporation chartered in 1993 with the specific purpose of assisting the City of Asheville in risk management and the administration of claims. The ACC is governed by a board of directors whose three members serve for one year or until successors are elected. One of the three members is appointed by the city manager. The board of directors elects the remaining members. The ACC has no assets or liabilities. All rights, title and interest to the claims contract with the City have been assigned to a bank trustee. All financing arrangements with the City have been disclosed in the accompanying notes to basic financial statements.

B. Related Organizations

Housing Authority of the City of Asheville (Housing Authority). The Mayor appoints the five-member Board of the Housing Authority of the City of Asheville. The City is accountable for the Housing Authority because it appoints the governing board; however, the City is not financially accountable for the Housing Authority.

Asheville City School System (School System). The Asheville City Council appoints the five-member Board of the Asheville City School System. The City is accountable for the School System because it appoints a majority of the governing board; however, the City is not financially accountable for the School System.

C. Jointly Governed Organizations

Asheville Regional Airport Authority. The City, in conjunction with Buncombe County, participates in a regional airport. Each participating government appoints three members and the six appointees then appoint one additional member to make up the seven-member board. The City has no obligation to fund any deficits, any claim on assets or obligation for liabilities. The Authority is included in Buncombe County's Financial Statements as a discretely presented component unit.

D. Measurement Focus Basis of Accounting & Financial Presentation

The accounts of the City are organized and operated on the basis of funds. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts comprised of assets, liabilities, fund equity, revenues, and expenditures or expenses, as applicable. Fund accounting segregates funds according to their intended purpose and is used to aid management in demonstration compliance with finance related legal and contractual provisions. The minimum number of funds is maintained consistent with legal and managerial requirements. In accordance with North Carolina Statutes, all funds of the City are maintained during the year using the modified accrual basis of accounting.

The government-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting*, as are the proprietary fund and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

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Non-exchange transactions, in which the City gives (or receives) value without directly receiving (or giving) equal value in exchange, include property taxes, grants and donations. On an accrual basis property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Amounts reported as program revenues include: 1) charges to customers or applicants for goods, services, or privileges provided, 2) operating grants and contributions, and 3) capital grants and contributions, including special assessments. Internally dedicated resources are reported as general revenues rather than as program revenues. Likewise, general revenues include all taxes.

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the City considers revenue to be available if they are collected within 60 days of the end of the current fiscal period, except for property taxes. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as expenditures related to compensated absences and claims and judgments, are recorded only when payment is due. Capital asset acquisitions are reported as expenditures in governmental funds. Proceeds from general long-term debt and acquisitions under capital leases are reported as other financing sources.

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations. The principal operating revenues of the City's enterprise funds are charges to customers for sales and services. The City also recognizes as operating revenue the portion of tap fees intended to recover the cost of connecting new customers to the water and sewer system. Operating expenses for enterprise funds include the cost of sales and services, administration expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

At June 30, taxes receivable are materially past due and are not considered to be an available resource to finance the operations of the current year. Also, as of January 1, 1993, State law altered the procedures for the assessment and collection of property taxes on registered motor vehicles in North Carolina. Effective with this change in the law, Buncombe County is responsible for billing and collecting the property taxes on registered motor vehicles on behalf of all municipalities in the County, including the City of Asheville. For motor vehicles registered under the staggered system, property taxes are due the first day of the fourth month after the vehicles are registered. The billed taxes are applicable to the fiscal year in which they become due. Therefore, the City's vehicle taxes for vehicles registered in Buncombe County from March 2004 through February 2005 apply to the fiscal year ended June 30, 2004. Uncollected taxes that were billed this period are shown as a receivable in these financial statements and are offset by deferred revenues.

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For vehicles registered under the annual system, taxes are due on May 1 of each year. For those vehicles registered and billed under the annual system, uncollected taxes are reported as a receivable on the financial statements and are offset by deferred revenues because the due date and the date upon which interest begins to accrue passed prior to June 30. The taxes for vehicles registered annually that have already been collected as of year-end are also reflected as deferred revenues at June 30, 2005 because they are intended to finance to City's operations during the 2005 fiscal year. Sales taxes collected and held by the State at year-end on behalf of the City are recognized as revenue. Intergovernmental revenues and sales and services are not susceptible to accrual because generally they are not measurable until received in cash. Grant revenues, which are unearned at year-end, are recorded as deferred revenues. Under the terms of the grant agreements, the City funds certain programs in combination of specific cost-reimbursement grants, categorical block grants and general revenues. Thus, when program expenditures are incurred, there are both restricted and unrestricted net assets available to finance the program. Excluding debt funding, it is the City's policy to first apply cost-reimbursement grant resources to such programs, followed by categorical block grants, and then by general revenues.

In the event that debt proceeds are included, the City will spend debt proceeds first unless there is an agreement tying specific expenditures to grant proceeds. When both restricted and unrestricted resources are available for use, it is the City's policy to use restricted resources first, and then unrestricted resources, as they are needed.

As permitted by accounting principles generally accepted in the United States of America, the City and the ABC Board have elected to apply only applicable FASB Statements and Interpretations issued on or before November 30, 1989, that do not contradict GASB pronouncements in its accounting and reporting practices for its government-wide and proprietary operations.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

The City reports the following major governmental fund:

General Fund - The General Fund is the general operating fund of the City. It is used to account for all financial resources except those required to be accounted for in other funds. The primary revenue sources are ad valorem taxes, various other taxes and licenses and State-shared revenues. The primary expenditures are for public safety, streets and highways, sanitation, recycling, parks and recreation, general government services, risk management and benefits, information technology and debt service for the payment of general long-term principal interest, and related costs.

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The City reports the following non-major governmental funds:

Special Revenue Funds - Special Revenue Funds are used to account for specific revenue sources that are legally restricted to expenditures for specific purposes. The City has the following Special Revenue Funds: Grant Programs, Community Development, Section 108 Rehabilitation, Affordable Home Ownership, and Housing Partnership.

Capital Project Funds - The Capital Project Funds are used to account for financial resources to be used for the acquisition and/or construction of major capital facilities (other than those financed by proprietary funds) and infrastructure. The City has four Capital Project Funds: Federal Capital Projects, General Capital Projects, Street/Sidewalk/Storm Drainage Capital Improvements and Sewer Capital Projects.

The City reports the following major proprietary fund:

Water Resources – The Water Resources Fund is an enterprise fund used to account for operations and maintenance of the City's water system that includes operation of two water treatment plants. This fund also covers acquisition and/or construction of major utility capital facilities and infrastructure, as well as the debt service for the payment of utility long-term debt principal, interest, and related costs.

The City reports the following non-major enterprise funds: Civic Center, Parking Services, Festivals and Mass Transit.

Additionally the City reports the following Fiduciary fund type:

Agency fund – Agency funds are custodial in nature and do not involve the measurement of operating results. The City maintains the Civic Center Agency Fund for the purpose of segregating the box office activities for the various promoters.

E. Budgetary Data

The City's budgets are adopted as required by the North Carolina General Statutes. An annual budget is adopted for the General Fund, Community Development Fund, Water Resources Fund and the other non-major Enterprise Funds. Multi-year budgets are adopted for the non-major Governmental Funds, except for the Community Development Fund, and Enterprise Capital Projects Funds. All annual appropriations lapse at the fiscal-year end. As required by State law [N. C. General Statute 159-26(d)], the City maintains encumbrance accounts, which are considered to be "budgetary accounts". Encumbrances outstanding at year-end represent the estimated amounts of the expenditures ultimately to result if unperformed contracts in progress at year-end are completed. Encumbrances outstanding at year-end do not constitute expenditures or liabilities. These encumbrances outstanding are reported as "reserved for encumbrances" in the fund balance section of the balance sheet and will be charged against the subsequent year's budget.

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All budgets are prepared using the modified accrual basis of accounting. Expenditures may not legally exceed appropriations at a functional level for all annually budgeted funds and a fund level or a project level for the multi-year project funds. Amendments are required for any revisions that alter the total functional or project budget and must be approved by the governing board. The City internally manages expenditures on a line item and departmental basis and although not legally required, budget amendments may be required between line items and between departments of the same function. The Budget department must approve all of these internal budget amendments and some of these amendments are forwarded to the City Manager for additional approval. During the year numerous budget amendments to the original budget were necessary. The budget ordinance must be adopted by July 1 of the fiscal year or the governing board must adopt an interim budget that covers that time until the annual ordinance can be adopted.

F. Assets, Liabilities, and Net Assets or Equity

1. Deposits and investments

The deposits of the City and the ABC Board are secured as required by North Carolina General Statute ("G. S.") 159-31. The City may establish official depositories with any bank or savings association whose principal office is located in North Carolina. The City and the ABC Board may establish time deposits in the form of NOW and SUPERNOW accounts, money market accounts, and certificates of deposits.

G.S. 159-30 (c) authorizes the City and the ABC Board to invest in obligations of the U.S. Treasury; obligations of any agency of the United State of America, provided the payment of the interest and principal of such obligations is fully guaranteed by the United States; obligations of the State of North Carolina; bonds and notes of any North Carolina local government or public authority; obligations of certain non-guaranteed federal agencies; certain high quality issues of commercial paper and bankers' acceptances; and the North Carolina Capital Management Trust (NCCMT), an SEC registered (2a-7) mutual fund.

The City and the ABC Board's investments with a maturity of more than one year at acquisition and non-money market investments are reported at fair value as determined by quoted market prices. The securities of the NCCMT Cash Portfolio are valued at fair value, which is the NCCMT's share price. The City intends, and has the ability, to hold all securities to maturity.

In accordance with State law, the City and the ABC Board have invested in securities, which are callable, and which provide for periodic interest rate increases in specific increments until maturity. These investments are reported at fair value as determined by quoted market prices. The City pools moneys from all funds, except unspent bond proceeds, to facilitate disbursement and investment and maximize investment income. Therefore, all cash and investments are essentially demand deposits and are considered cash and cash equivalents. The City and the ABC Board consider demand deposits and investments purchased with an original maturity of three months or less, which are not limited as to use, to be cash and cash equivalents.

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2. Receivables and payables

According to the North Carolina General Statutes, ad valorem taxes levied on July 1 beginning of the fiscal year, are due September 1, but interest and penalties do not accrue until the following January 6, the lien date.

Property taxes on certain registered motor vehicles are assessed and collected throughout the year. The taxes are based on the assessed values as of January 1, 2004.

Within the fund financials ad valorem taxes receivable are not accrued as revenue because the amount is not considered "available." At June 30, taxes receivable are significantly past due and are not considered to be an available resource to finance the operations of the subsequent year. Accounting principles generally accepted in the United States of America state that property tax revenues, which are measurable but not available, should be recorded as unearned revenues. The receivable amount is reduced by an allowance for doubtful accounts and an amount equal to the net receivable is included in the governmental balance sheet and the statement of net assets. Any property taxes collected in advance of the fiscal year to which they apply are recorded as unearned revenues.

An allowance for doubtful accounts is maintained on the ad valorem taxes receivable as described above. The City also maintains an allowance for doubtful accounts for water service accounts receivable and other miscellaneous receivables.

3. Inventories and prepaids

Inventory is determined by physical count and valued at cost (using the first-in, first-out method). Inventory in the governmental funds consists of expendable supplies held for consumption. The cost thereof has been recorded in inventory at the time items were purchased. Expenditure occurs when items are issued from inventory.

Certain payments to vendors reflect costs applicable to future accounting periods and are reported as prepaids in both government-wide and fund financial statements and are expended/expensed as balances are used.

4. Restricted assets

Certain cash balances are held as restricted. Restricted cash in the General Fund relates to the City's self-insurance program and are only available to pay claims. Restricted cash in the Water Resources Fund relates to unspent debt proceeds and is only available for specific projects. Restricted cash in the non-major governmental funds relates to cash held in trust to be loaned out under the City's Section 108 Rehabilitation Loan program and perpetual care of the City's cemetery.

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5. Capital assets

Capital assets, which include land, buildings, equipment, vehicles and infrastructure (e.g., water & sewer lines, water tanks, roads, sidewalks and similar items), are reported in the applicable governmental or business-type activities columns in the government-wide financial statements. Capital assets (not including general infrastructure) are defined by the City as assets with an initial, individual cost of more than \$5,000 and an estimated useful life in excess of two years. General infrastructure assets are defined by the City as assets with an initial cost of more than \$50,000. Assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at estimated fair market value at the date of donation.

Governmental infrastructure assets (roads, sidewalks, bridges, etc.) acquired prior to July 1, 2003, consist of assets acquired or that received substantial improvements subsequent to July 1, 1980, and are reported at estimated historical cost using deflated replacement costs. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Any interest incurred during the construction phase of proprietary fund type capital assets is reflected in the capitalized value of the asset constructed. Capital assets of the City and the ABC Board are depreciated using the straight-line method over the following estimates useful lives:

<u>Capital asset</u>	<u>Life</u>
Machinery and equipment	3-15 years
Building and improvements	20-50 years
Water System	50 years
Infrastructure	25-50 years

6. Compensated absences

The vacation policy of the City provides for the accumulation of up to a maximum of 40 days earned vacation leave, with such leave being fully vested when earned. All vacation pay is accrued when incurred in the government-wide, proprietary fund, and component unit financial statements. The City has assumed a last in first out method of using compensated time. The portion of that time that is estimated to be used in the next fiscal year has been shown as due within one year in note 7-H. ABC Board employees may accumulate up to 30 days earned vacation and such leave is fully vested when earned.

The City and the ABC Board's sick leave policy provides for an unlimited accumulation of earned sick leave. Sick leave does not vest, but any unused sick leave accumulated at the time of retirement may be used in the determination of length of service for retirement benefit purposes. Since neither of the two entities is obligated for the accumulated sick leave until it is actually taken, no liability for sick leave has been recorded.

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7. Long-term obligations

In the government-wide financial statements, and the proprietary fund financial statements long-term debt and other long-term obligations are reported as liabilities in the applicable governmental activities, business-type activities, or proprietary fund statement of net assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance cost are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental funds recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

8. Net Assets/Fund Balances

Net assets in government-wide and proprietary fund financial statements are classified as invested in capital assets, net of related debt; restricted; and unrestricted. Restricted net assets represent constraints on resources that are either externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or imposed by law through state statute.

In the governmental fund financial statements, reservations of the fund balance represent amounts that are not available for appropriation or are legally restricted by outside parties for use for a specific purpose. Designations of fund balance represent tentative management plans that are subject to change.

State law [G.S. 159-13 (b)(16)] restricts appropriation of fund balance for the subsequent year's budget to an amount not to exceed the sum of cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts as those amounts at the close of the fiscal year preceding in the budget year.

The governmental fund types classify fund balances as follows:

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Reserved

Reserved for Inventories – portion of fund balance that is not available for appropriation because it represents the year-end balance of inventories, which are not expendable available resources.

Reserved for Prepaids – portion of fund balance that is not available for appropriation because it represents the year-end balance of prepaids, which are not expendable available resources.

Reserved for Encumbrances – portion of fund balance available for appropriation to pay for commitments relating to unperformed contracts and purchase orders.

Reserved for Affordable Housing loans – portion of fund balance that is not available for appropriation because it represents loans receivable.

Reserved for Employee Paid Health Benefits – portion of fund balance that is not available for appropriation because it represents employee withholdings held in trust to be used to pay health claims.

Reserved by State Statue – portion of fund balance not available for appropriation after consideration of other reservations of fund balance. G.S. 159-13(b)(16) restricts appropriation of fund balance or fund equity to an amount not to exceed the sum of cash and investments minus the sum of liabilities, encumbrances, and deferred revenues arising from cash receipts as these amounts stand at the close of the fiscal year preceding the budget year.

Reserved for Perpetual Care – portion of fund balance available for appropriation to pay for maintenance of the City's cemetery.

Unreserved

Designated for Subsequent Year's Budget - portion of total fund balance which has been appropriated in the 2005-2006 budget ordinance.

Designated for Capital Projects - portion of total fund balance available for appropriation, which has been designated for governmental capital projects through approved multi-year project budget ordinances.

Designated for Law Enforcement Separation Allowance – portion of total fund balance, which has been designated for the actuarially determined un-funded portion of the law enforcement officers' special separation allowance.

Designated for Affordable Housing - portion of total fund balance, which has been designated for the City's Affordable Housing Program.

Undesignated - portion of total fund balance for appropriation, which is uncommitted at year-end.

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NOTE 2 – DEPOSITS AND INVESTMENTS

All deposits of the City and the ABC Board are made in official depositories as designated by the governing bodies and are secured as required by North Carolina G.S. 159-31. The governing bodies may designate as an official depository any bank or savings association whose principal office is located in North Carolina. Also, the governing bodies may establish time deposit accounts such as NOW and SuperNOW accounts, money market accounts and certificates of deposit. The City's and the ABC Board deposits must be either insured or collateralized by using one of two methods. Under the dedicated method, all deposits over the federal depository insurance coverage are collateralized with securities held by the City and the ABC Board's agents in the City and the ABC Board's name. Under the pooling method, a collateral pool, all uninsured deposits are collateralized with securities held by the State Treasurer's agent in the name of the State Treasurer. Since the State Treasurer is acting in a fiduciary capacity for the City and the ABC Board, these deposits are considered to be held by the City and the ABC Board's agent in the City's or the ABC Board's name. The amount of the pledged collateral is based on an approved averaging method for non-interest bearing deposits and the actual current balance for interest bearing deposits. Depositories using the pooling method report to the State Treasurer the adequacy of their pooled collateral covering uninsured deposits. The State Treasurer does not confirm this information with the City and the ABC Board or the escrow agent. Because of the inability to measure the exact amount of collateral pledged for the City or the ABC Board under the pooling method, a potential exists for under-collateralization, and this risk may increase in periods of high cash flows. However, the State Treasurer of North Carolina enforces strict standards of financial stability for each pooling method depository. The City and the ABC Board have no policy regarding custodial risks for deposits.

At June 30, 2005, the City's deposits had a carrying amount of \$18,015,267 and a bank balance of \$18,025,170. Of the bank balance, \$17,425,170 was covered by collateral held under the Pooling Method and \$600,000 was covered by federal depository insurance. The City also had \$49,275 in petty cash at year-end.

During 2005, the City did not realize any gain or loss from the sale of investments. The calculation of realized gains is independent of the calculation of the net increase/decrease in the fair value of investments that have been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments, reported in the prior year. The net decrease in fair value during 2005 for the City was \$53,000. This amount takes into account all changes in fair value (including purchases, sales and maturities) that occurred during the year. The unrealized gain on investments held at year end was \$131,055.

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As of June 30, 2005 the City had the following investments and maturities:

Investment Type	Fair Value	0-6 Months	6-12 Months	1-3 Years	3+ years
US Government Securities	\$ 5,198,910	\$ 746,400	\$ 1,488,440	\$ 2,964,070	\$ -
US Government Agencies	21,280,754	3,188,986	8,312,410	8,290,143	1,489,215
Commercial Paper	7,154,886	7,154,886	-	-	-
NC Cap Mgt Trust-Cash Portfolio	3,552,189	3,552,189	-	-	-
Escrow Money Markets	2,778,229	2,778,229	-	-	-
NC Cap Mgt Trust-Term Portfolio*	288,199	288,199	-	-	-
NC State Ed Asst Authority	1,000,000	-	-	-	1,000,000
Total:	<u>\$ 41,253,167</u>	<u>\$ 17,708,889</u>	<u>\$ 9,800,850</u>	<u>\$11,254,213</u>	<u>\$ 2,489,215</u>

*Because the NC Capital Management Trust Term Portfolio had a weighted average maturity of 0.9 years, it was presented as an investment with a maturity of 6-12 months.

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the City's investment policy requires purchases of securities to be laddered with staggered maturity dates and limits all securities to a final maturity of no more than six years.

Credit Risk. The City will minimize credit risk by limiting investments to the safest type of securities, by pre-qualifying all with whom the City will do business and by diversifying the portfolio. State law limits investments in commercial paper to the top rating issued by nationally recognized statistical rating organizations (NRSROs). As of June 30, 2005, the City's investments in commercial paper were rated P1 by Standard & Poor's, and A1 by Moody's Investors Service. The City's investments in the NC Capital Management Trust Cash Portfolio carried a credit rating of AAAM by Standard & Poor's as of June 30, 2005. The City's investment in the NC Capital Management Trust Term Portfolio is unrated. The Term Portfolio is authorized to invest in obligations of the US government and agencies, obligations of the State of North Carolina, bonds and notes of North Carolina local governments/public authorities and in high grade money market instruments as permitted under North Carolina G.S. 159-30 as amended. The City's investments in US Agencies (Federal Home Loan Bank) are rated AAA by Standard & Poor's and Aaa by Moody's Investors Service.

Custodial Credit Risk. For an investment, custodial credit risk is the risk that in the event of the failure of the counterparty, the City will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The City's investments are insured

or registered or held by the City or its agent in the City's name. The City has no policy on custodial risk.

Concentration of Credit Risk. The City diversifies its investments by security and institution with the exception of US Treasury and Agency securities. No more than 30% of the City's total investment portfolio will be invested in a single security type.

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NOTE 3 – RECEIVABLES AND UNEARNED ASSETS

Receivables as of year-end for the City's fund financials and government-wide totals, including the applicable allowances for uncollectible accounts, are as follows:

	General Fund	Non-major Gov't Funds	Gov't Activities	Business-Type Activities
Customers	\$ -	\$ -	\$ -	\$ 4,866,554
Property Taxes	968,162	-	968,162	-
Due From Other Governments	5,372,938	66,158	5,439,096	290,476
Accounts Receivable	410,310	22,232	432,542	302,654
Loans Receivable	-	5,602,900	5,602,900	-
Less: Allowance	(781,737)	-	(781,737)	(133,546)
Receivables (Net)	<u>\$ 5,969,673</u>	<u>\$ 5,691,290</u>	<u>\$ 11,660,963</u>	<u>\$ 5,326,138</u>

In conformity with accounting principles generally accepted in the United States of America, revenues that are measurable but not available are reported as unearned revenues in the fund statements. In addition, revenues collected in advance of the fiscal year to which they apply are reported as unearned assets.

At the June 30, 2005, the various components of deferred/unearned revenues were as follows:

	General Fund	Non-major Gov't Funds	Accrual Adjustments	Gov't Activities	Business-Type Activities
Property Taxes	\$ 555,174	\$ -	\$ (186,574)	\$ 368,600	\$ -
Grants and Contracts	-	550,383	(550,383)	-	-
Loans	-	3,829,772	(3,829,772)	-	-
Customers	-	4,263	(4,263)	-	361,377
Other	4,450	2,000	(2,000)	4,450	-
Total	<u>\$ 559,624</u>	<u>\$ 4,386,418</u>	<u>\$ (4,572,992)</u>	<u>\$ 373,050</u>	<u>\$ 361,377</u>

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NOTE 4 – CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005 was as follows:

	Beginning Balances as restated	Additions	Retirements	Transfers In (Out)	Ending Balances
Governmental Activities:					
Capital assets, <u>Non-depreciable:</u>					
Land	\$ 20,192,831	\$ 445,007	\$ (17,100)	\$ -	\$ 20,620,738
Construction in Progress	4,730,071	3,711,433	(1,933,201)	-	6,508,303
Total Capital Assets, Non-depreciable	<u>24,922,902</u>	<u>4,156,440</u>	<u>(1,950,301)</u>	<u>-</u>	<u>27,129,041</u>
Capital Assets, <u>Depreciable:</u>					
Building & Improvements	39,096,666	117,568	(33,174)	-	39,181,060
Machinery & Equipment	24,780,456	3,100,405	(1,163,940)	19,669	26,736,590
Infrastructure	216,143,023	77,349	-	-	216,220,372
Total Capital Assets, Depreciable	<u>280,020,145</u>	<u>3,295,322</u>	<u>(1,197,114)</u>	<u>19,669</u>	<u>282,138,022</u>
Less Accumulated <u>Depreciation For:</u>					
Buildings & Improvements	11,728,500	1,478,469	-	-	13,206,969
Machinery & Equipment	16,366,493	1,872,771	(1,162,432)	19,669	17,096,501
Infrastructure	76,510,120	9,862,728	-	-	86,372,848
Total Accumulated Depreciation	<u>104,605,113</u>	<u>13,213,968</u>	<u>(1,162,432)</u>	<u>19,669</u>	<u>116,676,318</u>
Total capital assets being depreciated, net	<u>175,415,032</u>				<u>165,461,704</u>
Governmental Activities Capital Assets, Net	<u>\$ 200,337,934</u>				<u>\$ 192,590,745</u>

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

	Beginning Balances as restated	Additions	Retirements	Transfers In (Out)	Ending Balances
Business-Type Activities:					
Capital Assets, <u>Non-depreciable:</u>					
Land	\$ 9,158,238	\$ -	\$ -	\$ -	\$ 9,158,238
Construction in Progress	4,306,879	1,484,384	(1,607,387)	-	4,183,876
Total Capital Assets, Non-depreciable	13,465,117	1,484,384	(1,607,387)	-	13,342,114
Capital Assets, <u>Depreciable:</u>					
Building & Improvements	77,972,923	1,539,089	(61,800)	-	79,450,212
Machinery & Equipment	12,084,755	795,536	(474,553)	(19,669)	12,386,069
Infrastructure	87,114,575	4,535,428	(7,245)	-	91,642,758
Total Capital Assets, Depreciable	177,172,253	6,870,053	(543,598)	(19,669)	183,479,039
Less Accumulated <u>Depreciation For:</u>					
Buildings & Improvements	22,877,832	1,984,419	(51,592)	-	24,810,659
Machinery & Equipment	9,328,645	884,747	(474,553)	(19,669)	9,719,170
Infrastructure	25,927,565	1,861,893	(4,431)	-	27,785,027
Total Accumulated Depreciation	58,134,042	4,731,059	(530,576)	(19,669)	62,314,856
Total capital assets being depreciated, net	119,038,211				121,164,183
Business-Type Activities Capital Assets, Net	\$ 132,503,328				\$ 134,506,297

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

Depreciation expenses were charged to functions of the City as follows:

Governmental Activities:

General Governmental	\$ 140,561
Public Safety	1,689,884
Highways & Streets	10,383,691
Cultural & Recreational	<u>1,013,048</u>

Total depreciation expense-Governmental Activities	<u><u>\$ 13,227,184</u></u>
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Business-type Activities:

Water Resources	\$ 3,832,185
Non-major Enterprise Funds	<u>894,731</u>

Total depreciation expense-Business-type Activities	<u><u>\$ 4,726,916</u></u>
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The City has numerous active construction projects as of June 30, 2005. These projects include new street construction, widening and improvements of existing streets, new parks and related facilities, fire stations, fire trucks and pumpers, water system improvements and new construction, water plant expansions and other City facilities and equipment. The amount the City was contractually committed to spend at June 30, 2005 was \$2,256,281 and \$1,971,695 for governmental activities and business-type activities, respectively.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

NOTE 5 – INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The composition of interfund balances as of June 30, 2005 is as follows:

Receivable Fund	Payable Fund	Amount
General	Community Development	\$ 13,973
	Affordable Home	19,892
	General Capital Project	63,039
	Parking Services	315,220
	Festival Fund	523,320
Total		<u>\$ 935,444</u>

The outstanding balances between funds result mainly from the time lag between the dates that
(1)interfund goods and services are provided or reimbursable expenditures occur,
(2)transactions are recorded in the accounting system, and (3)payments between funds are made.

The amounts payable to the General Fund relate to working capital loans made to the funds listed above.

Due to primary government and operating unit

Receivable entity	Payable Entity	Amount
Primary Government	Component unit-ABC Board	<u>\$ 210,817</u>

The amount payable to the general fund is a result of timing of funds due.

Interfund
transfers:

Transfer Out	Transfers In		
	Non-Major Governmental	Business Type Activities	Total
General Fund	<u>\$ 3,547,407</u>	<u>\$ 1,941,282</u>	<u>\$ 5,488,689</u>

Transfers are used to move unrestricted general fund reserves to finance various programs that the government must account for in other funds in accordance with budgetary authorizations, including amounts provided as subsidies or matching funds for various programs.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

NOTE 6 - LEASES

Capital Leases. The City has entered into a capital lease agreement with a local financial institution for the lease of a fire truck. The obligation bears an interest rate of 7.25 percent and matures in January 2007. The obligation is considered a limited obligation of the City and is secured by the asset itself. Future minimum lease payments, including interest of \$4,212, are as follows:

Fiscal year Ending June 30	Governmental Activities
2006	25,617
2007	24,970
Total	\$ 50,587

NOTE 7 - LONG TERM OBLIGATIONS

A. Installment Financing Contracts. The City has entered into various installment financing contracts with the Asheville Public Financing Corporation, a blended component unit, for renovation and construction of municipal facilities. These contracts were funded by the execution and delivery of Certificates of Participation and certain lease contracts. The outstanding contracts at June 30, 2005 are as follows:

	Interest Rates	Date Issued	Date Series Matures	Amount of Original Issue	Balance Outstanding June 30, 2005
Governmental Activities:					
Municipal Building Series 1997-A	4.00-5.13	11/1/1997	6/1/2018	14,045,000	10,535,000
Refunding Series 1997-B	4.00-5.00	11/1/1997	6/1/2011	3,480,000	2,210,000
Total Governmental					12,745,000
Business-type Activities:					
Parking Services Series 1992	5.00-6.50	2/15/1992	2/1/2008	5,385,000	1,610,000
Total Installment Financing Contracts					\$ 14,355,000

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

Annual debt service requirements to maturity for Installment Financing Contracts, including interest of \$213,525 for Business-type Activities and \$4,527,825 for the governmental activities, are as follows:

Fiscal Year Ending June 30	Business-type Activities	Governmental Activities	Total
2006	\$ 609,650	\$ 1,562,138	\$ 2,171,788
2007	606,825	1,562,437	2,169,262
2008	607,050	1,565,208	2,172,258
2009		1,560,178	1,560,178
2010-2013	-	5,379,245	5,379,245
2014-2018	-	5,643,619	5,643,619
Total	<u>\$ 1,823,525</u>	<u>\$ 17,272,825</u>	<u>\$19,096,350</u>

B. Installment Purchase Contracts. The City has entered into installment purchase contracts with various agencies for the purchase of assorted assets. These obligations are considered a limited obligation of the City and are secured by the assets themselves.

	Interest Rates	Date Issued	Date Series Mature	Amount of Original Issue	Balance Outstanding at June 30, 2005
Trucks and cans	5.12%	12/9/1999	12/9/2009	\$ 359,230	\$ 100,729
Trash cans	3.75	2/13/2001	8/13/2006	1,070,353	376,831
Azalea Park assets	0.00	5/3/2001	4/3/2006	822,148	153,374
Azalea Park assets	5.50	11/14/2001	10/14/2006	630,990	212,092
Fire Trucks	3.06	11/29/2002	11/15/2012	1,546,308	1,159,731
Radio equipment	2.64	1/28/2003	1/17/2008	309,790	190,720
Trucks and cans	2.07	5/28/2003	5/15/2007	667,530	340,638
Trucks and carts	2.35	4/30/2004	4/30/2009	741,577	599,064
Total Installment Purchase Contracts					<u>\$ 3,133,179</u>

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

Annual maturities on all installment purchase contracts, including interest of \$237,709 for the governmental activities, are as follows:

Fiscal Year Ending June 30	Governmental Activities	Total
2006	\$ 1,159,352	\$ 1,159,352
2007	837,516	837,516
2008	429,155	429,155
2009	357,887	357,887
2010-2013	586,978	586,978
Total	<u>\$ 3,370,888</u>	<u>\$ 3,370,888</u>

C. General Obligations Bonds. The City has issued general obligation bonds to provide funds for the acquisition and construction of major capital facilities related to both general and proprietary activities. All general obligation bonds are backed by the full faith, credit and taxing power of the City. Principal and interest requirements are appropriated when due.

General obligation bonds outstanding at June 30, 2005 are as follows:

	Interest Rates	Date Issued	Date Series Matures	Amount of Original Issue	Balance Outstanding at June 30, 2005
Government Activities:					
Street, sidewalk & storm drainage, Series 1993A	5.50-5.25%	7/1/1993	2/1/2013	\$ 1,300,000	\$ 670,000
Street, sidewalk & storm drainage, Series 1993B	5.00-5.25	7/1/1993	2/1/2013	500,000	280,000
General obligation refunding bonds, Series 1993C	4.00-4.80	7/1/1993	6/1/2008	10,305,000	2,635,000
General obligation refunding bonds, Series 1999	4.00-4.20	2/9/1999	6/1/2012	4,952,360	2,520,887
General obligation refunding bonds, Series 2000	4.75-5.00	12/1/2000	12/1/2020	1,970,000	1,570,000
Total government activities					<u>7,675,887</u>
Business-type Activities					
Water - 1995	5.40-6.40	6/1/1995	6/1/2011	3,000,000	1,500,000
Water - 1999	4.00-4.20	2/9/1999	6/1/2012	12,217,640	6,219,113
Total Business-type Activities					<u>7,719,113</u>
Total General Obligation Bonds					15,395,000
Premium on bonds					22,473
Total General Obligation Bonds and Premium on bonds					<u>\$ 15,417,473</u>

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

Annual debt service requirements to maturity for general obligation bonds are as follows:

Fiscal Year Ending June 30	Business type Activities		Governmental Activities	
	Principal	Interest	Principal	Interest
2006	\$ 1,306,300	\$ 326,263	\$ 1,618,700	\$ 351,666
2007	1,288,510	272,512	1,601,490	277,408
2008	1,373,899	219,470	1,471,101	203,908
2009	1,348,994	163,015	706,006	136,935
2010-2013	2,401,410	156,285	1,508,590	290,218
2014-2018	-	-	500,000	130,000
2019-2021	-	-	270,000	18,750
Total	<u>\$ 7,719,113</u>	<u>\$ 1,137,545</u>	<u>\$ 7,675,887</u>	<u>\$ 1,408,885</u>

D. Revenue Bonds. The City has issued revenue bonds to finance additions, extensions, and capital improvements to the water system of the City and its surrounding areas. The bonds are special obligations of the City, secured by and paid solely from the revenues from the operations of the water system. The taxing power of the City is not pledged for the payment of the principal or interest on the revenue bonds and no owner has the right to compel the exercise of the taxing power of the City or the forfeiture of any of its property in connection with any default under the bond order.

	Interest	Date Issued	Date Series Matures	Amount of Original Issue	Balance Outstanding at June 30, 2005
1996 series	4.3-5.62%	10/1/1996	8/1/2025	\$ 33,000,000	\$ 30,680,000
2001 series	3.3-5.25	1/2/2001	8/1/2025	13,300,000	<u>12,280,000</u>
Total Revenue Bonds					<u>\$ 42,960,000</u>

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

Revenue bond debt service requirements to maturity are as follows:

Fiscal Year Ending June 30	Principal	Interest
2006	\$ 1,185,000	\$ 2,276,244
2007	1,240,000	2,219,846
2008	1,295,000	2,159,733
2009	1,360,000	2,095,634
2010-2013	6,135,000	7,650,983
2014-2018	9,675,000	7,485,408
2019-2023	12,665,000	4,410,582
2024-2026	9,405,000	795,329
Total	<u>\$ 42,960,000</u>	<u>\$ 29,093,759</u>

E. State Water Bond Loan. In 1998, the City received a \$3,000,000 loan from the North Carolina Department of Environment, Health and Natural Resources for capital construction to the water system. The loan bears interest at 5.3 percent and is payable in equal annual amounts of \$150,000 over the next 20 years. The outstanding balance at June 30, 2005 was \$1,800,000.

F. Due to Other Governmental Units. The City also owes \$1,400,000 on outstanding "Section 108" loans.

G. Estimated Claims Incurred But Not Reported. The City is self-insured for workers compensation, fringe benefits and certain general liability and casualty risks. The City's Third Party Administrators have estimated the City's liability for claims incurred but not reported as of June 30, 2005 to be \$2,139,090 of which \$615,351 relates to fringe benefits and is estimated to be due within one year.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

H. Changes in Long Term Liabilities

	Beginning Balances	Additions	Retirements	Ending Balances	Due Within One Year
Governmental Activities					
General Obligation Bonds	\$ 9,101,212	\$ -	\$ 1,425,325	\$ 7,675,887	\$ 1,618,700
Installment					
Financing Contracts	13,800,000	-	1,055,000	12,745,000	920,000
Purchase Contracts	4,208,465	-	1,075,286	3,133,179	1,066,258
Capital Leases	67,490	-	21,115	46,375	22,679
Due To Other					
Governments	1,632,033	-	232,033	1,400,000	170,000
Accrued Vacation Payable	3,434,817	2,426,212	2,439,450	3,421,579	2,426,211
Estimated Claims Incurred					
But Not Reported	2,756,502	4,967,245	5,584,657	2,139,090	615,351
Unfunded Pension					
Obligations	602,718	98,584	-	701,302	-
Total Governmental Activities	<u>\$ 35,603,237</u>	<u>\$ 7,492,041</u>	<u>\$ 11,832,866</u>	<u>\$ 31,262,412</u>	<u>\$ 6,839,199</u>

Accrued payable and unfunded pension obligations have typically been liquidated by the general fund.

	Beginning Balances	Additions	Retirements	Ending Balances	Due Within One Year
Business-Type Activities					
General Obligation Bonds	\$ 9,289,473	\$ -	\$ 1,570,360	\$ 7,719,113	\$ 1,306,300
Revenue Bonds	44,090,000	-	1,130,000	42,960,000	1,185,000
Installment Financing Contracts	2,080,000	-	470,000	1,610,000	505,000
Installment Purchase Contracts	33,018	-	33,018	-	-
State Water Bond Loan	1,950,000	-	150,000	1,800,000	150,000
Accrued Vacation Payable	326,647	267,445	254,799	339,293	267,445
Unamortized Bond Proceeds	25,685	-	3,212	22,473	-
Total Business-Type Activities	<u>\$ 57,794,823</u>	<u>\$ 267,445</u>	<u>\$ 3,611,389</u>	<u>\$ 54,450,879</u>	<u>\$ 3,413,745</u>

I. DEBT MARGIN. The City is subject to the Local Government Bond Act of North Carolina, which limits the amount of net bonded debt the City may have outstanding to 8 percent of the appraised value of property subject to taxation. At June 30, 2005, such statutory limit for the City was \$534,321,351 providing a legal debt margin of approximately \$518,900,666.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

NOTE 8 – ACCOUNTS PAYABLE AND OTHER ACCRUED LIABILITIES

Accounts payable and other accrued liabilities at year-end consisted of the following:

	General Fund	Non-major Governmental Funds	Governmental Activities	Business-Type Activities
Due To Vendors	\$ 2,144,493	\$ 869,801	\$ 3,014,294	\$ 1,241,278
Due To Other				
Governments	251,837	-	251,837	2,887,293
Salaries and Benefits	1,264,614	15,976	1,280,590	339,293
Total	\$ 3,660,944	\$ 885,777	\$ 4,546,721	\$ 4,467,864

NOTE 9 – RISK MANAGEMENT

The City of Asheville, by nature of its various operations, is exposed to numerous risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions on behalf of employees, elected officials, public officials, and appointed members of boards and commissions; injuries to employees; and a variety of losses stemming from natural disasters and perils.

The City has determined that it is in its best interest to establish a self-insurance program for certain general liability and casualty risks, fringe benefits and its workers' compensation obligations. Revenues and expenses for this program are recorded in the Risk and Benefits Management Fund Division of the General Fund.

For all of its self-insured retention programs, the City retains the services of outside third party administrators for the professional management and adjustment of claims.

The City is further protected by the placement of a \$15,000,000 excess-only liability program across the liability lines under the contract. The City also insures its real and personal property holdings, including its dams, for a total of \$240,000,000 in assets. Coverages include sub-limits for flood and earthquake.

The City of Asheville is also self-insured as provided under North Carolina General Statutes for Workers Compensation and Employer Liability. The City retains out-of-pocket losses for \$300,000 on specific claims and an aggregate loss fund of \$3,600,000 over a three-year period. The City carries a \$3,000,000 specific and aggregate excess over these deductibles, with the aggregate excess attachment at 75 percent of the aggregate loss fund, over a three-year period.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

The employee medical benefits program is funded through the City of Asheville Employee Health and Benefits Trust. The Trust is funded by both employee and employer contributions. Fringe benefits paid through this trust include group health, dental and some life insurance. The group health plan operates with a specific stop loss of \$75,000 and an aggregate stop loss of 125 percent of the estimated loss fund.

Settlement of claims in all classes of liability except the City's group health program has not exceeded the City's limits of retention in any of the past twelve years. The group health program, on an annual basis, exceeds the specific stop loss, and therefore recovers excess losses an average of ten times per year over the past ten years. Recoveries under stop loss coverage are regularly forwarded to the Health Benefits Trust Account. The City of Asheville has never exceeded an aggregate stop loss attachment for its group medical program for any year.

The following is a summary of changes in claims liability at June 30:

	<u>2004</u>	<u>2005</u>
Beginning Balance	\$ 3,269,672	\$ 2,756,502
Plus incurred claims		
& changes in estimates	5,165,058	4,967,245
Less claim payments	<u>(5,678,228)</u>	<u>(5,584,657)</u>
Ending balance	<u>\$ 2,756,502</u>	<u>\$ 2,139,090</u>

The ABC Board is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The ABC Board has property, general liability, auto liability, workers' compensation and employee health coverage. The ABC Board also has liquor legal liability coverage.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

NOTE 10 – PENSIONS PLAN OBLIGATIONS

Employee Retirement Systems

A. North Carolina Local Governmental Employees' Retirement System.

Plan Description. The City of Asheville and the ABC Board contribute to the statewide Local Governmental Employees' Retirement System (LGERS), a cost-sharing multiple-employer defined benefit pension plan administered by the State of North Carolina. LGERS provides retirement and disability benefits to plan members and beneficiaries. Article 3 of G.S. Chapter 128 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly. The Local Governmental Employees' Retirement System is included in the Comprehensive Annual Financial Report (CAFR) for the State of North Carolina. The State's CAFR includes financial statements and required supplementary information for LGERS. That report may be obtained by writing to the Office of the State Controller, 1410 Mail Service Center, Raleigh, North Carolina 27699-1410, or by calling (919) 981-5454.

Funding Policy. Plan members are required to contribute six percent of their annual covered salary. The City and the ABC Board are required to contribute at an actuarially determined rate. For the City, the current rate for employees not engaged in law enforcement and for law enforcement officers is 4.8 percent and 4.78 percent, respectively, of annual covered payroll. For the ABC Board, the current rate for employees not engaged in law enforcement and for law enforcement is 4.95 percent and 4.78 percent, respectively, of annual covered payroll. The contribution requirements of members and of the City of Asheville and the ABC Board are established and may be amended by the North Carolina General Assembly. The City's contributions to LGERS for the years ended June 30, 2005, 2004, and 2003 were \$1,694,191, \$1,592,559 and \$1,532,444, respectively.

The ABC Board's contributions to LGERS for the years ended June 30, 2005, 2004, and 2003 were \$95,081, \$83,741 and \$75,965, respectively. The contributions made by the City and the ABC Board equaled the required contributions for each year.

In order to meet its statutory obligations for a death benefit under NCLGERS, the City of Asheville opts to provide a death benefit through a group term life insurance program, which is provided on a non-contributory basis to all members of the retirement system after 30 days of employment. The benefit pays the designated beneficiary an amount equal to one time the annual salary based on rate of pay at the time of death. The plan also provides an accidental death and dismemberment feature of two time's annual salary in the event of death by a covered member.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

B. Law Enforcement Officers Special Separation Allowance

1. Description

The City and the ABC Board administer a public employee retirement system (the "Separation Allowance"), a single-employer defined benefit pension plan that provides retirement benefits to the City's qualified sworn law enforcement officers. The Separation Allowance is equal to .85 percent of the annual equivalent of the base rate of compensation most recently applicable to the officer for each year of creditable service. The retirement benefits are not subject to any increases in salary or retirement allowances that may be authorized by the General Assembly. Article 12D of G.S. Chapter 143 assigns the authority to establish and amend benefit provisions to the North Carolina General Assembly. Separate Financial Statements are not issued for the Plan.

All full-time law enforcement officers of the City and the ABC Board are covered by the Separation Allowance. At December 31, 2004, the Separation Allowance's membership consisted of:

	<u>City</u>	<u>ABC Board</u>
Retirees receiving benefits	13	-
Active plan members	<u>158</u>	<u>2</u>
Total	<u>171</u>	<u>2</u>

2. Summary of Significant Accounting Policies

Basis of Accounting. The City and the ABC Board have chosen to fund the Separation Allowance on a pay as you go basis. For the City, pension expenditures are made from the General Fund, which is maintained on the modified accrual basis of accounting. The financial statements of the ABC Board are prepared using the accrual basis of accounting. Benefits are recognized as expenses when due and payable in accordance with the terms of the plan. Administrative expenses are recognized when incurred.

Method Used to Value Investments. No funds are set aside to pay benefits and administration costs. These expenditures are paid as they come due.

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

3. Contributions

The City is required by Article 12D of G.S. Chapter 143 to provide these retirement benefits and has chosen to fund the benefit payments on a pay as you go basis through appropriations made in the General Fund operating budget. The City and ABC Board's obligation to contribute to this plan is established and may be amended by the North Carolina General Assembly. There were no contributions made by employees of the City or the ABC Board. The ABC Board is required by Article 12D of G.S. Chapter 143 to provide these retirement benefits and has chosen to pay benefits and administration costs on a pay-as-you-go basis. For the current year the ABC Board was not required to pay any benefits. The ABC Board has chosen not to have an actuarial study performed because the liability is considered to be immaterial.

The annual required contribution for the current year was determined as part of the December 31, 2004 actuarial valuation using the projected unit credit actuarial cost method. The actuarial assumptions included (a) 7.25 percent investment rate of return (net of administrative expenses) and (b) projected salary increases of 5.9 to 9.8 percent per year. Both (a) and (b) included an inflation component of 3.75 percent. The assumptions did not include post-retirement benefit increases.

Annual Pension Cost and Net Pension Obligation. The City's annual pension cost and net pension obligation to the Separation Allowance for the current year were as follows:

Annual required contribution	\$ 291,233
Interest on net pension obligation	43,696
Adjustment to annual required contribution	(33,811)
Annual pension cost	<u>301,118</u>
Contributions made	202,534
Increase in net pension obligation	<u>98,584</u>
Net pension obligation beginning of year	<u>602,718</u>
 Net pension obligation end of year	 <u><u>\$ 701,302</u></u>

Three-Year Trend Information:

Fiscal Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/2003	\$250,132	54.61%	\$490,032
6/30/2004	268,448	58.02	602,718
6/30/2005	301,119	67.26	701,302

CITY OF ASHEVILLE
NOTES TO BASIC FINANCIAL STATEMENTS
June 30, 2005

C. Law Enforcement Officers Supplemental Retirement Income Plan and Special Separation Allowance

401(k) Retirement Plan

The City and the ABC Board contribute to the Supplemental Retirement Income Plan (Plan), a section 401(k) defined contribution pension plan administered by the Department of State Treasurer and a Board of Trustees. The Plan provides retirement benefits to law enforcement officers employed by the City and the ABC Board. Article 5 of G.S. Chapter 135 assigns the authority to establish and amend benefits provisions to the North Carolina Assembly.

Funding Policy: Article 12E of G.S. Chapter 143 requires the City and the ABC Board to contribute each month an amount equal to five percent of each officer's salary and all amounts collected are vested immediately. In addition to the required contribution for law enforcement officers, the City makes a monthly contribution equal to four percent of non-police employees' salary. Also, law enforcement officers and non-police employees of the City may make voluntary contributions to the Plan. The City contribution for law enforcement officers for the year ended June 30, 2005 was \$364,521 and the officers' voluntary contributions were approximately \$130,887. The City's contribution for non-police personnel was \$1,404,266 with the voluntary contributions of approximately \$810,744. The ABC Board's required contribution was \$3,952.

NOTE 11 – COMMITMENTS AND CONTINGENT LIABILITIES

A. Grant Revenues - The City receives amounts from federal, state, and local government agencies in the form of grants. The disbursement of funds under these programs is subject to audit in accordance with the Office of Management and Budget Circular A-133 *Audit of States, Local Governments, and Non-Profit Organizations and the State Single Audit Implementation Act*. The City expects the amount, if any, of expenditures that may be disallowed by the granting agencies as a result of these audits to be immaterial.

B. Claims and Litigation - The City is a defendant in other various lawsuits. Although the outcome of these lawsuits is not presently determinable, it is the opinion of the City's attorney and management that the resolution of these matters will not have a material adverse effect on the financial condition of the City.

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C. Limited Obligation Agreements – On June 1, 1991, the City entered into an installment purchase contract with Asheville-Buncombe Development Corporation (ABDC) for the purpose of financing municipal facilities construction projects. As of January 1, 1992, all ABDC rights and obligations under that contract were assigned to Asheville Public Financing Corporation (APFC). Effective November 1, 1997, the City executed Amendment Number One to the Installment Purchase Contract, with APFC, to provide conduit funding of the construction of a high tech flex building by Biltmore Farms and the renovation of the Grove Arcade as a public market place by the Grove Arcade Public Market Foundation. The contract was funded by the execution and delivery of \$5,515,000 of Taxable Certificates of Participation, Series 1997C. The Certificates bear interest at variable rates as determined monthly (monthly interest rate is equal to the one-month LIBOR published in the Wall Street Journal the first business day of each month, rounded up to the nearest 1/16th plus 59 basis points) with various maturity dates through the fiscal year ended June 30, 2018. The average interest rate from the date of initial execution and delivery through June 30, 2005 was 5.80 percent. The total amount of the Certificates outstanding at June 30, 2005 was \$2,175,000.

The Contract does not directly or indirectly or contingently obligate the City to make any payments beyond those appropriated in the year in which this contract is in effect.

NOTE 12 – DEFICIT FUND BALANCES/NET ASSETS

Liabilities exceeded assets, which created negative fund balances/net assets at year-end in the following funds:

Governmental Funds:		
General Capital Projects	\$	347,972
Proprietary Funds:		
Festivals	\$	809,170

The deficits in the governmental funds are due to timing differences that will be covered by grant reimbursements and transfers from the General Fund. The deficit in the Festivals fund is expected to be reduced by additional revenues from new events in the coming year.

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NOTE 13 – RESTATEMENT

Beginning net assets for governmental activities and beginning governmental fund balances have been adjusted and restated to more appropriately reflect the effect of transactions that should have been recorded in previous years. The following summarizes the effect of the restatement:

	General Fund	Non-major Governmental Funds	Accrual Adjustments	Governmental Activities
Beginning fund balances/ Net Assets	\$ 32,481,678	\$ 3,166,396	\$ 168,965,228	\$ 204,613,302
Adjustment for inventory reserve	-	-	654,729	654,729
Transfer of Housing Partnership from the General Fund to the Special Revenue Fund	(1,893,662)	1,893,662	-	-
Beginning fund balances/ Net assets (as restated)	<u>\$ 30,588,016</u>	<u>\$ 5,060,058</u>	<u>\$ 169,619,957</u>	<u>\$ 205,268,031</u>

NOTE 14 – SUBSEQUENT EVENTS – WATER AGREEMENT

Under the General Statutes of North Carolina, cities may establish different schedules of rates, charges and fees for “public enterprise” services (e.g., water, sewer) furnished beyond the corporate limits (different from rates, charges and fees for those same services within the city).

In the late 1920’s the City took over the operation of lines that had been operated by various small water districts on its periphery. Connected with that, the N.C. General Assembly in 1933 adopted an act known as the “Sullivan Act,” which essentially prohibited the City of Asheville from charging different rates for water provided to users not located within the City who were connected to lines constructed and financed by the water districts.

In 1981, the City and Buncombe County (for itself and for the various water districts) entered into the Water Agreement. By its terms, the Water Agreement provided that customers of the system would be charged the same rates for water, whether they were located inside or outside of the corporate limits, and further provided that the rate limitations provision of the Sullivan Act could not be challenged. This essentially expanded the coverage of the Sullivan Act by agreement.

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In May 2004, the City gave notice of its intent to terminate the Water Agreement, effective June 30, 2005. The City and County tried to negotiate a successor agreement, but no agreement was reached. On June 29, 2005, the N.C. General Assembly adopted "Sullivan Acts II and III." These local acts were introduced by the members of the General Assembly representing Buncombe County (including Asheville). This was apparently done at the request of, and with the assistance of, Buncombe County officials. The City neither sought nor consented to this legislation, and was not consulted prior to its introduction. The effect of Sullivan Acts II and III is essentially to expand the coverage of the 1933 Sullivan Act to prevent the City from establishing different schedules of rates, fees and charges for water service provided beyond the city limits. There is no requirement (as under the 1933 Sullivan Act) that the user be connected to a district-financed line.

The City has filed a complaint in Wake County Superior Court, against the State of North Carolina, seeking a declaratory judgment that all of the Sullivan Acts (1933, II and III) are local acts regulating trade or commerce, or relating to public health or sanitation, and were adopted in violation of prohibitions against such acts contained in the North Carolina Constitution. The complaint also alleges, under the law of the land clause, that the Sullivan Acts unconditionally discriminate against the City.

Regardless of the outcome of the legal action, the City of Asheville has regained sole governance and budget authority of a Water System that was formerly governed by a fragmented triumvirate consisting of the Water Authority, the Buncombe County Commission and the Asheville City Council.